85-1371

Supreme Court, U.S.
FILED
FEB 18 1986
JOSEPH F. SPANIOL, JR.
CLERK

In the
SUPREME COURT OF THE UNITED STATES

October Term, 1985
No.

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

Petitioner,

-against-

FORBES, INC.,

Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE NEW YORK COURT OF APPEALS**

FREDERICK A. O. SCHWARZ, JR.,
Attorney for Petitioner,
100 Church Street,
New York, New York 10007.
(212) 566-3329 or 8642

GLENN NEWMAN,
STANLEY BUCHSBAUM,
PETER RABINOWITZ,

of Counsel.

February 14, 1986.

## QUESTION PRESENTED

Under the New York City franchise tax law, the tax applies to the business income of a corporation after allocation by a three factor formula (property, receipts, and wages and salaries). Investment income normally is subject to a different allocation formula, based on the weighted averages of the same three factor formula as applied separately to each issuer of securities providing investment income.

1. Where the portion of investment income treated as taxable, under the New York City franchise tax measured by income, is determined by the amount of contact the issuers of securities have with the City, is the tax, although found to be rational, discriminatory within the meaning of 31 U.S.C. §742 because, under some circumstances, a holder of securities issued by entities

with no contact with the City will pay less tax than if it held Federal obligations?

2. Where a percentage guideline for determining whether the normal investment allocation percentage does not properly reflect the "activity, business, income or capital" of a corporation in the City and, therefore, requires application of a statutorily required alternative which, under certain circumstances, results in a similar reduction in tax for one who holds securities of an entity with no contact with the City as contrasted with one holding federal obligations, does such a guideline, otherwise rational, constitute discrimination in violation of 31 U.S.C. §742?

3. Do the circumstances discussed in Questions 1 and 2 result in a violation of the Supremacy Clause of the Constitution?

## TABLE OF CONTENTS


| | Page |
|---|---|
| QUESTION PRESENTED..... | i |
| OPINION BELOW ..... | 1 |
| JURISDICTION ..... | 2 |
| CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED ..... | 2 |
| STATEMENT OF THE CASE ..... | 9 |
| REASONS FOR GRANTING THE PETITION ..... | 9 |
| CONCLUSION ..... | 14 |
| APPENDIX A ..... | 1a |


## TABLE OF AUTHORITIES

**Cases:**


| | |
|---|---|
| Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983) ..... | 11 |
| Phillips Co. v. Dumas School Dist., 361 U.S. 376 (1960) .. | 9-11 |


**Authorities:**


| | |
|---|---|
| United States Constitution ... | 2-3 |
| 31 U.S.C. §742..... | 3 |

Page

Admin. Code R46-2.0, subd. 4 . 4-5

Admin. Code R46-4.0, subd. 3 . 5-7

Admin. Code R46-4.0, subd. 8 . 7-8

In the
SUPREME COURT OF THE UNITED STATES

October Term, 1985
No.

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

Petitioner,

-against-

FORBES, INC.,

Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE NEW YORK COURT OF APPEALS**

The Department of Finance of the City of New York petitions for a writ of certiorari to review the final order of the Court of Appeals of the State of New York entered in this case.

## OPINION BELOW

The opinion of the Court of Appeals (App., infra, 1a-29a) is reported at 66 NY 2d 243, ___ N.E. 2d ___. The

order of the Appellate Division of the New York Supreme Court, affirming the determination of the Department of Finance, is officially reported, although no opinion was written, at 102 AD 2d 1013.

## JURISDICTION

The order of the New York Court of Appeals was entered on November 19, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(3).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2, of the United States Constitution provides:

> "Clause 2. Supreme Law of Land
>
> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State

> shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

31 U.S.C. §742 read as follows*:

> "§742, Exemption from taxation.
>
> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

The New York City tax law involved is the General Corporation Tax, imposed by Title R of Chapter 46 of the New

---

* This section was repealed and replaced in 1982 by 31 U.S.C. §3124, an essentially similar provision.

York City Administrative Code. Section R46-2.0 thereof contains the following provisions:

> "4. 'Investment capital' means investments in stocks, bonds and other securities, corporate and governmental, not held for sale to customers in the regular course of business, exclusive of subsidiary capital and stock issued by the taxpayer, provided, however, that, in the discretion of the director of finance there shall be deducted from investment capital any liabilities payable by their terms on demand or within one year from the date incurred, other than loans or advances outstanding for more than a year as of any date during the year covered by the report, which are attributable to investment capital;
>
> 5. 'Investment income' means income, including capital gains in excess of capital losses, from investment capital, to the extent included in computing entire net income, less, (a) in the discretion of the director of finance, any deductions allowable in computing entire net income which are attributable to investment capital or investment income, and (b) such portion of any net operating

> loss deduction allowable in computing entire net income, as the investment income, before such deduction, bears to entire net income, before such deduction, provided, however, that in no case shall investment income exceed entire net income;"

Section R46-4.0 provides the method for computing the tax. Subdivision 3 thereof, provides for an allocation of income within the City of New York:

> "3. The portion of the entire net income of a taxpayer to be allocated within the city shall be determined as follows:
>
> (a) multiply its business income by a business allocation percentage . . .
>
> (b) multiply its investment income by an investment allocation percentage to be determined by
>
> (1) multiplying the amount of its investment capital invested in each stock, bond or other security (other than governmental securities) during the period covered by its report by the percentage, if any, of the entire capital or the issued capital

BEST AVAILABLE COPY

stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the city on the report or reports, if any, required of any such issuer or obligor under this title or under title QQ of this chapter, for the preceding year, provided, however, that for taxable years ending in or with calendar year nineteen hundred sixty-six, such percentage shall be presumed to be that percentage, if any, of the entire capital or the issued capital stock, or the gross direct premiums, or the net income, as the case may be, of the issuer or obligor thereof required to be allocated within the state on the report or reports, if any, required of any such issuer or obligor under the tax law or the insurance law for the preceding year, unless the taxpayer establishes the actual percentage which such issuer or obligor would have been required to allocate within the city had this title been in effect for such year, or which such issuer or obligor did allocate within the city under title QQ of this chapter, but without regard to any minimum.

(2) adding together the sum so obtained, and

(3) dividing the result so obtained by the total of its investment capital invested during such period in stocks, bonds and other securities (other than obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities); provided, however, that in case any investment capital is invested in any stock, bond or other security during only a portion of the period covered by the report, only such portion of such capital shall be taken into account; and provided further, that if a taxpayer's investment allocation percentage is zero, interest received on bank accounts, on obligations of the United States and its instrumentalities and on obligations of the state of New York, its political subdivisions and its instrumentalities shall be multiplied by its business allocation percentage; and

(c) add the products so obtained."

The allocation method, however, is subject to adjustment, as provided in subdivision 8 of §R46-4.0:

BEST AVAILABLE COPY

"8. If it shall appear to the director of finance that any business or investment allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the city, the director of finance shall be authorized in his discretion, in the case of a business allocation percentage, to adjust it by (a) excluding one or more of the factors therein, (b) including one or more other factors, such as expenses, purchases, contract values (minus subcontract values), (c) excluding one or more assets in computing such allocation percentage, provided the income therefrom is also excluded in determining entire net income, or (d) any other similar or different method calculated to effect a fair and proper allocation of the income and capital reasonably attributable to the city, and in the case of an investment allocation percentage to adjust it by excluding one or more assets in computing such percentage provided the income therefrom is also excluded in determining entire net income. The director of finance from time to time shall publish all rulings of general public interest with respect to any application of the provisions of this subdivision." (Emphasis ours.)

## STATEMENT OF THE CASE

All the essential facts in this case are well stated in the opinion of the New York Court of Appeals (App 1a-29a).

The constitutional issues involved were first raised by the respondent in a memorandum of law submitted by it to the administrative hearing officer after the close of the hearing. Those issues were raised again in the petition to the State court for review of the decision of the City's Department of Finance and in briefs to the State's appellate courts -- the Appellate Division of the Supreme Court, First Department, and the Court of Appeals.

## REASONS FOR GRANTING THE PETITION

In Phillips Co. v. Dumas School Dist., 361 U.S. 376 (1960), the State tax was held invalid on the ground of discrimination because it applied

to the full value of leased real property owned by the Federal government while those with similar leases from the State or its political subdivisions were not taxed at all on their leaseholds. The approach of the Court in considering the question indicates that reasonableness of the classification should be considered in determining whether the tax is discriminatory. Before the Court set the tax aside, it gave consideration to the reasonableness of the statutory provision (pp. 383-385). The Court found it was not reasonable.

The opinion points out that the test for reasonableness in equal protection cases does not necessarily govern in tax immunity cases involving governments. "But we have made it clear, in the equal protection cases, that our decisions in that field are not

necessarily controlling where problems of intergovernmental tax immunity are involved" (p. 385).

The case relied most heavily upon by the New York Court of Appeals, Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), plainly was one without any appropriate reasonable basis for the classification. It imposed the tax on the net earning of banks and defined net earnings to include income from obligations of the United States and its instrumentalities. The tax, however, excluded net earnings from obligations of the taxing State, Tennessee, and its political subdivisions.

In the present case the situation is quite different. The City and State of New York obligations are treated in exactly the same manner as those of the United States and its instrumen-

talities. The aim of the tax to rely on contact with the City to determine the percentage of business income subject to the tax and to use an analogous method to determine the percentage of investment income to be taxed is a rational one. The Court below stated (App. 24a; 66 N.Y. at p. 252):

> "There is undoubtedly a rational basis for both the definition of IAP [Investment Allocation Percentage] and the 18% rule. It is not irrational to allocate investment income by the extent to which an issuer does business in the City, and it is not irrational to conclude that the Federal Government has greater contacts with the City than do other States. Similarly, it is not irrational to seek to correct distortions that may occur where, as here, a taxpayer virtually avoids all tax on investment income by investing a small amount in the obligations of corporations having little contact with the City and the balance in zero-valued securities."

It is in light of the fair and reasonable purpose of the challenged provision of the tax law and the fact that the percentage of receipts taxed remains the same whether the proceeds come from United States obligations, those of the State or City of New York, or those from other States that the issue of "nondiscrimination" must be considered.

Concededly, if the sole motive were to reduce the percentage of investment receipts paid by foreign States subject to the tax, it would be advantageous to buy obligations of any State aside from New York rather than to buy United States obligations. This, however, is a sound and rational tax, which imposes no greater tax on receipts from Federal obligations than it does on receipts from any other obligations. It should not be invalidated because

it happens to result in a lesser tax on the corporation owning obligations of another State as contrasted to one owning those of the United States. Certainly, neither New York City nor the State of New York is attempting to discriminate between their own instrumentalities and those of the United States.

## CONCLUSION

This petition for a writ of certiorari should be granted.

February 14, 1986

Respectfully submitted,

FREDERICK A. O. SCHWARZ, JR.,
Corporation Counsel of
the City of New York,
Attorney for Petitioner.

GLENN NEWMAN,
STANLEY BUCHSBAUM,
PETER RABINOWITZ,

of Counsel.

## APPENDIX A

In the Matter of FORBES, INC., Appellant, v. DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK, Respondent. Argued October 10, 1985; decided November 19, 1985.

## OPINION OF THE COURT

**KAYE, J.**

By rendering investments in obligations of the Federal Government less attractive than other investments, in the calculation of taxes due under New York City's General Corporation Tax, the City tax discriminates against Federal obligations within the meaning of the Federal statute permitting only nondiscriminatory franchise taxes to be levied on United States obligations (31 USC former §742 [renum §3124]), and therefore violates the supremacy clause of the United States Constitution (US Const, art VI, cl 2).

## THE CITY'S TAX LAW

New York City imposes a general corporation tax, based upon net income, on both domestic and foreign corporations "[f]or the privilege of doing buisness, or of employing capital, or of owning or leasing property in the city in a corporate or organized capacity, or of maintaining an office in the city" (Administrative Code of City of New York §R46-3.0[1]). Consistent with this purpose, the City has established rules for allocating corporate income for tax purposes, depending upon the connection between that income and the City. The allocation rules differ for income derived from a taxpayer's business operations (business income) and income derived from a taxpayer's investments (investment income). Allocated income is taxed at a rate of 9%.

BEST AVAILABLE COPY

The portion of a taxpayer's business income allocated to the City is determined by multiplying the taxpayer's total business income by the taxpayer's "business allocation percentage" (BAP) (see, Administrative Code §R46-4.0[3][a]). The BAP essentially seeks to measure the percentage of the taxpayer's business income derived from property, sales, services and receipts in the City. Thus, if a taxpayer conducts 60% of its business in the City, its BAP is 60%, and it will be taxed on 60% of its business income.

The portion of a taxpayer's investment income allocated to the City, in contrast, is derived by measuring the contacts of the issuers of the obligations or securities in which the taxpayer invests, rather than the contacts of the taxpayer. In the case

of corporate obligations, this measurement, called the "investment allocation percentage" (IAP), is the issuer's BAP. Thus, if a taxpayer's investments consist solely of the securities of one corporation, the portion of the taxpayer's investment income to be allocated to the City is determined by multiplying the taxpayer's total investment income by the BAP of the corporation issuing those securities (see, Administrative Code §R46-4.0[3][b]).

Although investment income from government obligations is treated somewhat differently, that difference logically flows from the principle that investment income is ordinarily taxable to the extent that the issuer has quantifiable contacts with the City. The City (and the taxpayer) can determine the BAP of an issuer of a corporate

BEST AVAILABLE COPY

obligation simply by examining the issuer's report containing this information (Administrative Code §R46-4.0[3][b][1]), which must be filed by all corporations doing business in the City (Administrative Code §R46-5.0). The absence of any report by a corporate issuer would indicate no business in the City, and the issuer's BAP (which becomes the taxpayer's IAP with respect to that issue) would be zero. Governmental authorities, however, do not file such returns or reports with the City from which the extent of their connection with the City might be measured. Since the City cannot readily quantify those contacts, it has developed the following rules to determine a taxpayer's IAP with respect to investments in government obligations (Administrative Code §R46-4.0[3][b][3]).

- Obligations of the 49 States other than New York are allocated wholly outside the City.

- Obligations of the Federal Government and of New York State, as well as cash and cash equivalents, are allocated in accordance with the taxpayer's IAP based on all other investments. However, if a taxpayer's IAP is zero - i.e., if a taxpayer has not invested in corporate obligations or has invested in corporate obligations of issuers all of which have BAP's of zero - income from these obligations is allocated based on the taxpayer's BAP.

Again applying the principle that investment income is taxable to the extent of the issuer's connection with the City, the theory behind these rules appears to be that States other than

New York generally have little if any contact with the City. Therefore, it is appropriate to allocate their obligations entirely outside the City. The Federal Government and New York State, on the other hand, plainly have a substantial presence in the City. But because that presence is unquantified, it is necessary and appropriate to attribute to their obligations the allocation percentage of a taxpayer's investments where the allocation percentages are more than zero and quantifiable.

Administrative Code §R46-4.0(3)(b) sets forth the method for determining a taxpayer's investment allocation percentage. In essence, the taxpayer's IAP is a fraction. The numerator is the combined allocated fair market value of all corporate obligations held by a taxpayer. The denominator is the taxpayer's total investment

capital, including the combined fair market value of corporate securities and the obligations of the other 49 States, but excluding "obligations of the United States and its instrumentalities and obligations of the state of New York, its political subdivisions and its instrumentalities", as well as cash or cash equivalents, such as bank accounts.

**APPELLANT'S TAX RETURNS**

An obvious objective of tax planning, given the City's tax scheme, would be for a taxpayer to minimize the tax on its investment income by investing in (a) a small amount of corporate obligations issued by corporations with low BAP's and (b) a large amount of Federal obligations. The

low IAP attributable to corporate obligations having a low BAP would thus apply to a taxpayer's entire investment portfolio, lowering its taxable investment income. Appellant's investment portfolio for tax year 1978 indeed reflects this planning:

| Issuer | IAP | Value |
|---|---|---|
| Sheraton | 4.8438% | $ 33,383 |
| Alabama Power | 0% | 34,547 |
| United States | N/A | 6,931,345 |
| Bank Accounts | N/A | 579,808 |
| | 2.38039% | $7,579,083 |

Appellant claimed in its 1978 return that its total income from these investments was $342,669, and that its allocated investment income was $8,157 ($342,669 x 2.38039%).

The City audited appellant's tax returns for each tax year in issue on this appeal (1977, 1978 and 1979),

and adjusted appellant's IAP by excluding its investment in Sheraton corporate obligations pursuant to Administrative Code §R46-4.0(8), which provides in relevant part: "If it shall appear to the director of finance that any business or investment allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the city, the director of finance shall be authorized in his discretion * * * in the case of an investment allocation percentage to adjust it by excluding one or more assets in computing such percentage provided the income therefrom is also excluded in determining entire net income." As a result of the exclusion, appellant's income attributable to its Sheraton investment was not taxed at all. But because the exclusion

reduced appellant's IAP to zero, the remaining investment income derived from Federal obligations and bank accounts was allocated based upon appellant's BAP rather than its IAP of 2.38%, in accordance with Administrative Code §R46-4.0(3)(b)(3). The net result of these recalculations was that appellant was assessed additional taxes in excess of $68,000, plus interest, which thereafter became the subject of this appeal.

**THE 18% RULE**

On appellant's petition to the Department of Finance for a redetermination of the additional assessment, the auditor who had examined the returns testified as to why he had excluded investments in Sheraton. According to the auditor, for each tax year he calculated the ratio between the value

of appellant's investments in corporate obligations and the total value of its investments, which yielded a percentage well under 2%. For example, for the tax year 1978, the percentage was 0.896% ($67,930 divided by $7,579,083). The auditor testified he had oral instructions that if the ratio were less than 18%, he was automatically to invoke the discretionary power provided by section R46-4.0(8). Based upon these instructions, he eliminated appellant's "non-zero investment allocation percentage securities", which consisted of the Sheraton obligations. This testimony was credited by the referee who heard appellant's petition for redetermination, and is set forth in the referee's findings. Nonetheless, the referee concluded that appellant had "not demonstrated that the Commissioner of Finance has abused his discretion, nor that the

Investment Allocation Percentages which [appellant] calculated properly reflected its investment activity. Accordingly, the Business Allocation Percentages were correctly applied at the audit level to [appellant's] interest income from Government Obligations and Bank Certificates of Deposit."

**THE BURDEN ON FEDERAL OBLIGATIONS**

The City tax law places a greater burden on taxpayers holding Federal obligations, thus making them less attractive investments, in two ways. First, the law discriminates in favor of the obligations of the other 49 States. Second, the law discriminates in favor of corporate obligations.

The first form of discrimination arises out of the method for calculating a taxpayer's IAP. While the numerator is based on the value of corporate

obligations, the denominator is based on the total value of investment capital, excluding United States obligations and bank accounts. Since the IAP is a fraction, the taxpayer is disadvantaged if the denominator is smaller. The following comparison of appellant's 1978 tax figures with those of a hypothetical taxpayer with otherwise identical investments - except for a presumed investment in Connecticut bonds rather than Federal obligations - is illustrative:

| | Appellant | Hypothetical Taxpayer |
|---|---|---|
| Sheraton/ Alabama | $ 67,930 | $ 67,930 |
| IAP | (2.38039%) | (2.38039%) |
| United States | 6,931,345 | 0 |
| Connecticut | 0 | 6,931,345 |
| Bank Accounts | 579,808 | 579,808 |
| | $7,579,083 | $7,579,083 |

In both cases, the numerator for calculating the IAP will be the same.

The fair market value of the corporate obligations ($67,930) is multiplied by the issuer's BAP (2.38039%). The resulting figure is $1.617. The denominators, however, are different. In appellant's return the denominator is $67,930, the fair market value of total investment capital excluding United States obligations and bank accounts. In the hypothetical return, the denominator will be $6,999,275 - the fair market value of the corporate and Connecticut obligations. Thus, appellant would have an IAP of 2.38039%, while the hypothetical taxpayer would have an IAP of .0231%. In 1978, appellant had total investment income of $342,669. It determined its taxable investment income by multiplying that figure by its IAP (2.38039%), resulting in a figure of $8,157. At a 9% tax rate, the tax on its investment income

was $734. Assuming that appellant had invested in Connecticut rather than Federal obligations and obtained the same total investment income, its taxable investment income would have been $79 ($342,669 x .0231%), yielding a tax of only $7.

The second form of discrimination arises out of the 18% rule. In effect, the rule penalizes a taxpayer who invests 82% or more of its capital in obligations other than certain corporate obligations - including Federal obligations. Appellant's total investment income for the tax year 1978 was $342,669. Assuming that the income attributable to Sheraton obligations was $3,000, the 18% rule had the following effect:

| | Without 18% Rule | With 18% Rule |
|---|---|---|
| Preallocation Investment Income | $342,669 | $339,669 |
| Allocation Percentage | 2.38039% | 60% |
| Taxable Investment Income | 8,157 | 203,801 |
| Tax (9%) | 734 | 18,342 |

Moreover, had appellant invested less than 82% of its investment capital in Federal obligations, and instead invested more in corporate obligations having low BAP's, it would have escaped the 18% rule and paid less tax. For example, assuming appellant had realized the same investment income by purchasing $1,067,930 in corporate obligations (rather than $67,930) and $5,931,345 in Federal obligations (rather than $6,931,345), and assuming that the allocation percentage of the additional

corporate obligations was also 2.38%, appellant's tax bill would have been $17,608 lower.

**THE FEDERAL STATUTE**

Appellant urges that the City's tax is unconstitutional because it conflicted with 31 USC §742 (renum 31 USC §3124[a]), which provided in relevant part: "[A]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and

except estate taxes or inheritance taxes." Appellant's position is that the City's tax is a franchise tax that impermissibly discriminates against obligations of the United States.*

---

* Appellant also argues that the 18% rule is invalid because it is a rule or regulation required to be published pursuant to New York City Charter §1105. While in general constitutional questions are not reached when a case can be decided on a nonconstitutional ground (see, Matter of Beach v. Shanley, 62 NY2d 241, 254), here even a determination that the 18% rule should have been published would not dispose of the more fundamental question whether on remittal the Commissioner could, in view of the discrimination, constitutionally exercise any discretion. Neither ground urged by appellant on this appeal was before us in Matter of Barney's, Inc. v. Department of Fin. (92 AD2d 642, affd. 61 NY2d 786).

In view of our conclusion that the tax is discriminatory, we need not reach the issue, tendered in the brief of the amicus curiae, whether it is indeed even a franchise tax.

Section 742 was "'principally a restatement of the constitutional rule'" (First Natl. Bank v. Bartow County Bd., 470 US ___, 105 S Ct 1516, 1522, quoting Memphis Bank & Trust Co. v. Garner, 459 US 392, 397) established by the Supreme Court beginning with McCulloch v. Maryland (4 Wheat [17 US] 316) that "'States may not impose taxes directly on the Federal Government, nor may they impose taxes the legal incidence of which falls on the Federal Government'" (Memphis Bank & Trust Co. v. Garner, 459 US 392, 397, supra, quoting United States v. County of Fresno, 429 US 452, 459). Section 742 and its predecessors were designed "'to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary

credit'" (Memphis Bank & Trust Co. v. Garner, 459 US 392, 396, supra, quoting Smith v. Davis, 323 US 111, 117). To this end, former section 742 provided "a 'sweeping' exemption for federal obligations" (First Natl. Bank v. Bartow, 470 US ___, 105 S Ct 1515, 1520, supra, quoting American Bank & Trust Co. v. Dallas County, 463 US 855, 862). "Congress intended to sweep away formal distinctions and to invalidate all taxes measured directly or indirectly by the value of federal obligations, except those specified" in the exclusion (American Bank & Trust Co. v. Dallas County, 463 US 855, 867, supra).

The exclusion contained in section 742 for nondiscriminatory franchise taxes was added to the statute in 1959 and embodies a court-created exception for "nondiscriminatory taxes imposed

on discrete property interests such as corporate shares or business franchises, even though the value of that discrete interest was measured by the underlying assets, including United States obligations" (American Bank & Trust Co. v. Dallas County, 463 US 855, 858, supra). A franchise tax is constitutional so long as it "remains the same whatever the character of the corporate assets may be" (Werner Co. v. Director of Taxation, 350 US 492, 493-494). In Werner, the court upheld a franchise tax based upon a corporation's net worth, which included the value of Federal bonds held by the taxpayer. On the other hand, a "state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations" (Memphis Bank

& Trust Co. v. Garner, 459 US 392, 397, supra).

As a practical matter, the City tax unquestionably imposes a greater burden on holders of Federal obligations than on holders of certain other obligations, and thereby diminishes to some degree the investment attractiveness of Federal obligations. Excluding Federal obligations from the denominator of the IAP, while including obligations of other States, effectively places a greater tax on the former than on the latter. The 18% rule compounds the problem, by disadvantaging taxpayers who invest 82% or more of the value of their portfolios in obligations other than those of corporations with low BAP's, including Federal obligations.

The City concedes that its tax has these effects, but argues that the tax is not discriminatory both

because it has a rational basis and because it does not favor New York State obligations over Federal obligations. Neither argument, however, would save the tax.

There is undoubtedly a rational basis for both the definition of the IAP [Investment Allocation Percentage] and the 18% rule. It is not irrational to allocate investment income by the extent to which an issuer does business in the City, and it is not irrational to conclude that the Federal Government has greater contacts with the City than do other States. Similarly, it is not irrational to seek to correct distortions that may occur where, as here, a taxpayer virtually avoids all tax on investment income by investing a small amount in the obligations of corporations having little contact with the City and the balance in zero-valued securities.

That the disparities may be rational for due process or equal protection purposes, however, is not relevant under section 742. Memphis Bank & Trust Co. v. Garner, (459 US 392, supra) makes clear that the controlling issue under section 742 is simply whether the tax adversely affects Federal obligations in comparison to other obligations. Phillips Co. v. Dumas School Dist. (361 US 376), heavily relied upon by the City, in fact undercuts its position. In Phillips, the school district argued that there was a rational basis for its tax on lessees of Federally owned real property, which was more onerous than the corresponding tax on lessees of State property. But the Supreme Court rejected this contention and held the tax unconstitutional because the State had an obligation to "treat those who deal with the [Federal] Govern-

ment as well as it treats those with whom it deals itself" (361 US, at p 385).

It is also beside the point that the tax scheme does not discriminate in favor of obligations of the State of New York. Typically, cases raising the issue of discrimination have involved situations in which States favored their own obligations (see, e.g., Memphis Bank & Trust Co. v. Garner, 459 US 392, supra). But nothing in the statute suggests that it should be so limited. To the contrary, the statutory goal of preserving Federal borrowing power is threatened whenever any other class of obligations is taxed more leniently than Federal obligations. In Schuylkill Trust Co. v. Pennsylvania (296 US 113), the State statute excluded the value of shares of Pennsylvania corporations held by the taxpayer. Although

the statute favored certain corporate (rather than Commonwealth of Pennsylvania) obligations, the court nonetheless found it improper: "If the burden of the tax be lifted in respect of some securities (as it is by confession from those issued by certain Pennsylvania corporations) it must necessarily fall on the remaining securities owned by the company" (296 US, at p 120). Similarly, cases such as United States v. County of Fresno (429 US 452, supra) and United States v. City of Detroit (355 US 466) support appellant's position, not respondent's. In County of Fresno, for example, California imposed a tax on renters of otherwise tax-exempt real property (including property owned by the Federal Government). The tax was constitutional, however, because the State imposed a corresponding property tax on owners

of nonexempt property which was passed on to renters. Consequently, those who rented from the Federal Government were "no worse off under California tax laws than those who work[ed] for private employers and rent[ed] houses in the private sector" (429 US, at p 465). Here, in contrast, appellant is "worse off" because it invested in Federal obligations rather than obligations of "the private sector" or of States other than New York.

Accordingly, the judgment of the Appellate Division should be reversed, with costs, the petition granted, the determination of respondent Department of Finance annulled, and the matter remitted to respondent for readjustment of appellant's tax liability for the tax years in issue (a) by calculating appellant's IAP as if its Federal obligations were obligations of a State other

than New York and (b) without adjusting appellant's IAP pursuant to section R46-4.0(8).

Chief Judge WACHTLER and Judges JASEN, MEYER, ALEXANDER and TITONE concur; Judge SIMONS taking no part.

Judgment reversed, with costs, petition granted, determination of respondent Department of Finance annulled, and matter remitted to Supreme Court, New York County, with directions to remand to respondent for further proceedings in accordance with the opinion herein.

Supreme Court, U.S.
FILED
MAR 14 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1371

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

*Petitioner,*

v.

FORBES INC.,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI
TO THE NEW YORK COURT OF APPEALS

## BRIEF IN OPPOSITION

ARNOLD BAUMAN
*Counsel of Record*

SHEARMAN & STERLING
53 Wall Street
New York, New York 10005
(212) 837-6860

*Of Counsel:*
CLARENCE W. OLMSTEAD, JR.
WILLIAM E. FLOWERS
KENNETH A. CARUSO
DANIEL LAVIN

*Attorneys for Respondent*

March 14, 1986

## QUESTION PRESENTED

Does New York City's General Corporation Tax discriminate against federal obligations, in violation of 31 U.S.C. § 742 (and hence, in violation of the Supremacy Clause), because, in the calculation of taxes due, the City tax law renders investments in federal obligations less attractive than investments in corporate obligations and obligations of the 49 states other than New York?

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| QUESTION PRESENTED | i |
| TABLE OF AUTHORITIES | iii |
| STATEMENT OF THE CASE | 1 |
| A. *The New York City General Corporation Tax* | 2 |
| 1. The Income Allocation Rules—Calculation of The Investment Allocation Percentage | 2 |
| 2. The 18 Percent Rule | 3 |
| B. *The Decision Below* | 4 |
| SUMMARY OF ARGUMENT | 6 |
| ARGUMENT | |
| THERE ARE NO SPECIAL AND IMPORTANT REASONS FOR REVIEW | 6 |
| A. *This Case Presents No Unsettled Question* | 6 |
| B. *This Case Presents No Decisional Conflict* | 7 |
| C. *The Decision Below is Correct* | 8 |
| D. *This Case Presents an Issue of Limited Significance and Impact* | 9 |
| CONCLUSION | 10 |
| LIST OF SUBSIDIARY CORPORATIONS | |

## TABLE OF AUTHORITIES


| Cases | PAGE |
|---|---|
| *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983) | 6 |
| *Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299, 69 A.2d 410 (1949), *cert. denied*, 339 U.S. 928 (1950) | 7, 9 |
| *Continental Bank v. Arizona Dep't of Revenue*, 131 Ariz. 6, 638 P.2d 228 (Ariz. App. 1981) | 7 |
| *Federal Products Corp. v. Norberg*, 429 A.2d 447 (R.I. 1981) | 7 |
| *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 105 S. Ct. 1516 (1985) | 6 |
| *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824) | 6 |
| *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819) | 6 |
| *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983) | 6, 7, 8, 9 |
| *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665 (1950) | 6 |
| *Phillips Petroleum Co. v. Dumas Independent School District*, 360 U.S. 376 (1960) | 8 |
| *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935) | 6, 8, 9 |
| *Schwinden v. Burlington Northern, Inc.*, 691 P.2d 1351 (Mont. 1984) | 7 |
| *Smith v. Davis*, 323 U.S. 111 (1944) | 6, 9 |
| *Society for Savings v. Bowers*, 349 U.S. 143 (1955) | 6 |
| *State ex rel. Douglas v. Karnes*, 216 Neb. 750, 346 N.W. 2d 231 (1984) | 7 |

PAGE

*Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492 (1956) ..... 6

*Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829) ..... 6

**Statutes**

31 U.S.C. § 742 .....2, 4, 7, 8

**Rules**

Sup. Ct. Rules, Rule 17 ..... 6, 7

**Other Authorities**

Administrative Code of the City of New York § R46-4.0(8) .....2, 3, 4

*N.Y. Times*, November 20, 1985 ..... 9

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1985

**No. 85-1371**

---

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK,

*Petitioner,*

v.

FORBES INC.,

*Respondent.*

---

ON PETITION FOR A WRIT OF CERTIORARI
TO THE NEW YORK COURT OF APPEALS

---

## BRIEF IN OPPOSITION

---

Forbes Inc. ("Forbes") respectfully submits this brief in opposition to the petition for a writ of certiorari (the "petition") of the Department of Finance of the City of New York (the "City").

## STATEMENT OF THE CASE

The City's unique rules for allocating corporate investment income place a greater tax burden upon holders of federal obligations than upon holders of other obligations. This fact—proven to a mathematical certainty in the proceedings below, and conceded by the City in the court below—led the New York Court of Appeals to conclude, in accordance with a long

line of applicable precedent, that the City tax law discriminates against federal obligations, in violation of 31 U.S.C. § 742 and hence, in violation of the Supremacy Clause. The City's rules (i) favor the obligations of the 49 states other than New York over federal obligations, and (ii) penalize any taxpayer which places more than 82% of its investment portfolio in federal obligations.

## A. The New York City General Corporation Tax

### 1. The Income Allocation Rules—Calculation of The Investment Allocation Percentage

The New York City General Corporation Tax imposes a tax upon that portion of a corporation's income which is "allocated" to the City pursuant to rules set forth in the Administrative Code of the City of New York (the "Code").

The portion of a taxpayer's *business income* allocated to the City is determined by multiplying the taxpayer's total business income by the taxpayer's "business allocation percentage" ("BAP"), the percentage of the *taxpayer's* business or capital in the City, as determined by a statutory formula.

The portion of a taxpayer's *investment income* allocated to the City is determined by multiplying the taxpayer's total investment income by the taxpayer's "investment allocation percentage" ("IAP"). Unlike the BAP, the IAP is not based on the *taxpayer's* contacts with the City, but on the collective, allocable contacts with the City of the *issuers* of the securities in which the taxpayer has invested.

With respect to *investment income* from *corporate obligations*, the *taxpayer's* IAP is based on the *issuers'* BAPs, allocated according to the taxpayer's relative investment in each such obligation. However, different allocation rules apply to *investment income* from *government obligations*:

(1) Obligations of the 49 states other than New York ("state obligations") are allocated wholly outside the City (i.e., they have an IAP of zero).

(2) Obligations of the federal government, and obligations of the State of New York ("New York obligations") are allocated in accordance with the otherwise prevailing IAP calculated by reference to the taxpayer's other investments (i.e., they have no independent IAP).

(3) If the taxpayer's IAP is zero—that is, if a taxpayer has not invested in corporate obligations, or has invested in the obligations of corporations all of which have BAPs of zero—interest income from federal obligations and from New York obligations (but not state obligations) is allocated in accordance with the taxpayer's BAP (which usually is much higher than its IAP).[1]

The IAP is a fraction. The numerator is the combined, allocated fair market value of all corporate obligations held by a taxpayer. The denominator is the taxpayer's "total investment capital," which the Code defines so as to *include* the value of corporate obligations and *state obligations*, but to *exclude* the value of *federal obligations* and *New York obligations*. For the tax years at issue—1977, 1978 and 1979—Forbes' IAP, calculated under the Code rules, ranged from approximately 1.4 percent to approximately 5.7 percent.

**2. The 18 Percent Rule**

Code § R46-4.0(8) vests the Commissioner of Finance (the "Commissioner") with "discretionary" power to adjust a taxpayer's IAP. It provides in pertinent part:

> If it shall appear to the [Commissioner] that any business or investment allocation percentage determined as hereinabove provided does not properly reflect the activity, business, income or capital of a taxpayer within the city, the [Commissioner] shall be authorized in his discretion . . . in the case of an investment allocation percentage *to adjust it by excluding* one or more assets in

---

1 The Code provisions setting forth the method for calculating the taxpayer's IAP are quoted at pages 5-7 of the petition.

> computing such percentage provided the income therefrom is also excluded in determining entire net income. (emphasis supplied)

In an audit of Forbes' tax returns, a City auditor calculated for each tax year the ratio between the value of Forbes' investments in corporate securities and the total value of Forbes' entire investment portfolio. The auditor had been instructed that if that ratio were less than 18 percent, the Commissioner's "discretionary" power should automatically be invoked.

Because the vast majority of its investments were in federal obligations, the foregoing ratio derived from Forbes' tax returns was well below 18 percent. The auditor automatically "adjust[ed]" Forbes' IAP by "excluding" Forbes' investments in corporate obligations. This reduced Forbes' IAP to zero. Accordingly, none of Forbes' income from corporate obligations was taxable, but Forbes' income from federal obligations was allocated (and became taxable) based upon Forbes' BAP (of approximately 60 percent) rather than its IAP (of approximately 1.4 to 5.7 percent).

The net result of these recalculations was that the City assessed against Forbes additional taxes in excess of $68,000, plus interest. Forbes challenged those assessments in the New York courts.

**B. The Decision Below**

In a unanimous decision (with one judge not participating), the New York Court of Appeals held that the City tax law "places a greater [tax] burden on taxpayers holding federal obligations, thus making them less attractive investments . . . ." (Appendix ["A"]-13a) Accordingly, the court concluded that the City tax laws discriminate against federal

obligations, in violation of 31 U.S.C. § 742 and the Supremacy Clause. The Court of Appeals specifically held:

> 1. The statutory formula for calculating the IAP discriminates against federal obligations in favor of state obligations by including the value of state obligations, but not federal obligations, in the denominator of the fraction, thereby permitting investments in state obligations, but not federal obligations, to lower the fraction and decrease the amount of taxable income. This makes state obligations more attractive to investors because, all other factors being equal, a taxpayer which invests in state obligations has a lower IAP, and pays less tax, than a taxpayer which invests in federal obligations. (A-13a-16a, 23a)
>
> 2. The 18 percent rule discriminates against federal obligations by penalizing a taxpayer which, like Forbes, invests more than 82 percent of its portfolio in federal obligations (or in any obligations, including federal obligations, other than those of corporations with low BAPs). (A-16a-18a, 23a)
>
> 3. This discrimination cannot be justified on the ground that the City tax law would satisfy a "rational basis" test applicable in a due process or an equal protection case. That test is not relevant under section 742, where the controlling issue is simply whether the tax adversely affects federal obligations in comparison to other obligations. (A-24a-26a)
>
> 4. The discrimination cannot be justified on the ground that the City tax law treats federal obligations and New York obligations identically. State obligations are taxed more leniently than federal obligations, thereby threatening the statutory goal of preserving federal borrowing power. (A-26a-28a)

## SUMMARY OF ARGUMENT

There are no "special and important reasons" why this Court should exercise its discretion to review this case. *See* Rule 17, Sup. Ct. Rules. The case presents no unsettled question of federal law. The decision below does not conflict with decisions of this Court, or of any state court of last resort, and is in any event correct. The case presents an issue of limited significance and impact. Accordingly, the petition should be denied.

## ARGUMENT

## THERE ARE NO SPECIAL AND IMPORTANT REASONS FOR REVIEW

As set forth below, there are no "special and important reasons" why this Court should exercise its discretion to review this case.

### A. This Case Presents No Unsettled Question

This case presents no unsettled question of federal law. On the contrary, the decision below is nothing more than a routine application of the law established in this Court's applicable precedents—some nearly as old as the Republic itself[2]—which have been repeatedly[3] and recently[4] reaffirmed. The decision

---

2 *See, e.g., M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819); *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824); *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829).

3 *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935); *Smith v. Davis*, 323 U.S. 111 (1944); *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665 (1950); *Society for Savings v. Bowers*, 349 U.S. 143 (1955); *Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492 (1956).

4 *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983); *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983); *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 105 S. Ct. 1516 (1985).

on which the Court of Appeals relied most directly—*Memphis Bank*—is a unanimous decision of three years' standing.

Thus, the case presents no "question of federal law which has not been, but should be, settled by this Court . . . . " Rule 17(c), *supra*. This Court has already defined the boundaries of state and local taxation of federal obligations under section 742. Indeed, it has addressed that statute on three occasions within the past three years, rendering decisions which provide clear and controlling guidance to the state courts. *See* note 3, *supra*.

The court below applied settled law to the case at hand. Nothing in the circumstances of this case—much less anything in the City's petition—provides the slightest reason why this Court should exercise its discretion to revisit these issues.

**B. This Case Presents No Decisional Conflict**

There is simply no reason to grant certiorari where, as here, the decision below stands not in conflict, but rather in harmony, with the decisions of this Court and the decisions of state courts which have addressed the issue presented.[5] Here, the Court of Appeals carefully reviewed no less than seven applicable decisions of this Court to find the test for "discrimination" under 31 U.S.C. § 742. (A18a-23a) The Court of Appeals quoted and applied the rule stated in *Memphis Bank*, a rule distilled from more than 150 years of constitutional litigation: "A 'state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations.' " (A-22a) The Court of Appeals held that the City tax "unquestionably" failed this test. (A-23a)

---

5 *Schwinden v. Burlington Northern, Inc.*, 691 P.2d 1351 (Mont. 1984); *State ex rel. Douglas v. Karnes*, 216 Neb. 750, 346 N.W. 2d 231 (1984). *See also Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299. 69 A.2d 410 (1949), *cert. denied*, 339 U.S. 928 (1950); *Continental Bank v. Arizona Dep't of Revenue*, 131 Ariz. 6, 638 P.2d 228 (Ariz. App. 1981); *Federal Products Corp. v. Norberg*, 429 A.2d 447 (R.I. 1981).

There is no suggestion in the petition—nor could there be—that the Court of Appeals' decision stands in conflict with *Memphis Bank*, or with any of the decisions of this or any other Court under section 742.

The City hints at a supposed conflict between the decision below and "[t]he approach" of the Court in *Phillips Petroleum Co. v. Dumas Independent School District*, 360 U.S. 376 (1960). *Phillips*, however, did not arise under section 742. Moreover, *Phillips* held that the "rational basis" test advocated by the City—a test drawn from equal protection cases—is not applicable where, as here, "problems of intergovernmental tax immunity are involved." 360 U.S. at 385. That, of course, is precisely what the Court of Appeals held below. The decision below is absolutely consistent with *Phillips*, in legal principle, in language, and in result.[6]

**C. The Decision Below is Correct**

In any event, the decision below is correct and warrants no further review. A simple exercise in mathematics (as reflected in the Court of Appeals decision, A-13a-18a) demonstrates that a taxpayer must pay a higher tax, all other factors being equal, when it invests in federal obligations. The Court of Appeals correctly held, in language drawn from *Memphis Bank*, that "the City tax unquestionably imposes a greater burden on holders of Federal obligations than on holders of certain other obligations, and thereby diminishes to some degree the investment attractiveness of Federal obligations." (A-23a) As noted above, this is clearly the correct test to apply. The discrimination was, in fact, so patent that the City conceded this issue in the court below.[7] (A-23a)

---

6 Even *Phillips* rejected the school district's argument in justification of a discriminatory tax on lessees of federal property.

7 Apparently, the City would seek in this Court to withdraw that concession. It argues that there is no discrimination because "the percentage of receipts taxed"—presumably, the 9% tax rate—is the same for all property. Petition at 13. This argument is frivolous. Discrimination derives from the statutory rules which determine *how*

Finally, the Court of Appeals held—correctly, in light of *Memphis Bank*, *Smith v. Davis*, 323 U.S. 111, 117 (1944), and *Schuylkill Trust Co. v. Pennsylvania*, *supra*, 296 U.S. at 120—that the tax law could not be salvaged merely because it treats New York obligations as badly as it treats federal obligations. (A-26a) "[T]he statutory goal of preserving Federal borrowing power is threatened whenever any other class of obligations is taxed more leniently than Federal obligations." (A-26a)

**D. This Case Presents an Issue of Limited Significance and Impact**

This case presents no issue of nationwide significance warranting discretionary review in this Court. It appears that the decision will have no impact outside the State of New York. Research has not disclosed any city or state, other than New York City and New York State, that uses investment income allocation rules of the kind involved here. The City does not contend otherwise.

Even within New York, the decision will apparently have little impact. As the City's counsel has publicly stated, most of the City's tax revenues are derived from taxes upon *business* income and therefore are not affected by the decision below, which invalidates only the rules for allocating *investment* income. *See N.Y. Times*, November 20, 1985, at D17. Because the decision below will have little impact even within the City

---

*much* income, and *which* income, is subject to taxation and which result in a greater tax burden on federal obligations, whether or not the overall "tax rate" is uniform.

Also meritless is the City's argument—never raised below—that the laws do not *intentionally* discriminate. Petition at 13. The absence of a discriminatory intent does not save a tax which actually imposes a greater tax burden on the holders of federal obligations. *Memphis Bank & Trust Co. v. Garner*, *supra*, 459 U.S. at 397-98; *Schuylkill Trust Co. v. Pennsylvania*, *supra*, 296 U.S. at 119-20 (examining the "operation" of the law); *Commonwealth v. Curtis Publishing Co.*, *supra*, 363 Pa. at 324, 69 A.2d at 421-22.

itself, discretionary review in this Court is particularly inappropriate.

## CONCLUSION

There are no "special and important reasons" why this Court should exercise its discretion to review this case. Accordingly, the petition for a writ of certiorari should be denied.

Dated: New York, New York
March 14, 1986

Respectfully submitted,

/s/ ARNOLD BAUMAN

Arnold Bauman
*Counsel of Record*

SHEARMAN & STERLING
53 Wall Street
New York, New York 10005
(212) 837-6860

*Of Counsel:*
CLARENCE W. OLMSTEAD, JR.
WILLIAM E. FLOWERS
KENNETH A. CARUSO
DANIEL LAVIN

*Attorneys for Respondent*

## LIST OF SUBSIDIARY CORPORATIONS

### Forbes Inc.

*Subsidiaries*

Forbes Investors Advisory Institute Inc.
Forbes Investors Advisory Institute Inc. (Delaware)
Forbes Trinchera Inc.
Sangre de Cristo Ranches Inc.
Fiji Forbes Inc.
Forbes Europe Inc.
Slegers-Forbes Inc.
Social Register Association